

# **Impact Investing An Introduction**

**Solvay Brussels School of Economics & Management**

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**Some context:  
major challenges and megatrends**

# Major challenges - geopolitical

## ***Global backlash against liberal democracy***

Rise of radical authoritarian parties and populism (extreme left and right) driven by :

- anti-immigration sentiment
- frustration about extreme poverty and corrosive income inequalities

*Trump election, Brexit vote, « gilets jaunes », rise of far right parties (Alternative for Germany, Vox, Sweden Democrats, Rassemblement National)*

- Increased risk of renewed cold war between West and China/Russia/North Korea

*Ukraine, China/US increasing tensions over Taiwan, Israel vs. Iran*

## ***Global climate crisis***

- Droughts, heatwaves (India, Pakistan, Sub-Saharan Africa, Western US)
- Climate refugees and economic disaster

*Extinction Rebellion, Greta Thunberg...*

# Major challenges - economic

- Inflationary pressures and possibility of recession
- Possible debt/banking crisis (private and public debt ratio at a historical high in a context of rising interest rates)
- Ageing population: threat to pension and healthcare systems
- Disrupting technology: ChatGPT, Uber, Facebook, Amazon, Tesla

*Can governments deal alone with these issues?*

*What is the role of business addressing big challenges (UN SDG)?*

*Companies have a huge and increasing footprint, « with great power comes great responsibility »*

**→ Private capital needs to find solutions at scale for social and environmental issues.**

# Some megatrends

Massive transfer of wealth to millennials – approx. USD 40 trillions – with value and mindset shift:

- Millennials want to impact favorably the lives of other people (will inherit a problematic planet if nothing is done)
- More female investors
- Pension contributors: starting to wonder what kind of world they are going to retire in.

Academic research suggest that companies focusing on ESG outperform others: positive causal link between performance and social/environmental responsibility → « profit for purpose » businesses may grow faster, be more profitable and resilient than a company based solely on risk and return

Societal expectations : Regulation, Work From Home, Citizens – Stakeholder expectations have gained velocity

Voting activity/activism becoming a tool to address challenges

# **Stakeholder capitalism**

# Stakeholder capitalism

Businesses have a responsibility that extends beyond their shareholders : generate shareholder value while tackling issues such as social justice and climate change

## **Blackrock 2018 letter – Larry Fink**

Larry Fink, CEO, Blackrock (world's largest asset manager with US\$10 trillion in AUM)

- “On the edge of a fundamental reshaping of finance”
- Climate risk is investment risk
- Every government, company and shareholder must confront climate change
- A company cannot achieve long term profit without embracing purpose and the needs of a broad range of stakeholders
- Disclosure should be a means to achieving a more sustainable and inclusive capitalism

# UN Sustainable Development Goals



# UN Sustainable Development Goals (SDG)

- Established to achieve a better and more sustainable future and to address problems related to poverty, inequality, climate and environmental degradation, prosperity, and peace and justice.
- Adopted by the United Nation in 2015, a « call to action »!
- Achieving the SDG's by 2030 requires 5 to 7 trillions annually
- The Rockefeller Foundation asserts that "The key to financing and achieving the SDGs lies in mobilizing a greater share of the \$200+ trillion in annual private capital investment flows toward development efforts, and philanthropy has a critical role to play in catalyzing this shift."



# SUSTAINABLE DEVELOPMENT GOALS

17 GOALS TO TRANSFORM OUR WORLD

<b>1</b> NO POVERTY 	<b>2</b> ZERO HUNGER 	<b>3</b> GOOD HEALTH AND WELL-BEING 	<b>4</b> QUALITY EDUCATION 	<b>5</b> GENDER EQUALITY 	<b>6</b> CLEAN WATER AND SANITATION 
<b>7</b> AFFORDABLE AND CLEAN ENERGY 	<b>8</b> DECENT WORK AND ECONOMIC GROWTH 	<b>9</b> INDUSTRY, INNOVATION AND INFRASTRUCTURE 	<b>10</b> REDUCED INEQUALITIES 	<b>11</b> SUSTAINABLE CITIES AND COMMUNITIES 	<b>12</b> RESPONSIBLE CONSUMPTION AND PRODUCTION 
<b>13</b> CLIMATE ACTION 	<b>14</b> LIFE BELOW WATER 	<b>15</b> LIFE ON LAND 	<b>16</b> PEACE, JUSTICE AND STRONG INSTITUTIONS 	<b>17</b> PARTNERSHIPS FOR THE GOALS 	 <b>SUSTAINABLE DEVELOPMENT GOALS</b>



## Dimensions of Sustainable Development

Sustainable development has been defined as development that meets the needs of the present without compromising the ability of future generations to meet their own needs.

For sustainable development to be achieved, it is crucial to harmonize three core elements: **economic** growth, **social** inclusion and **environmental** protection.



# UN SDG's



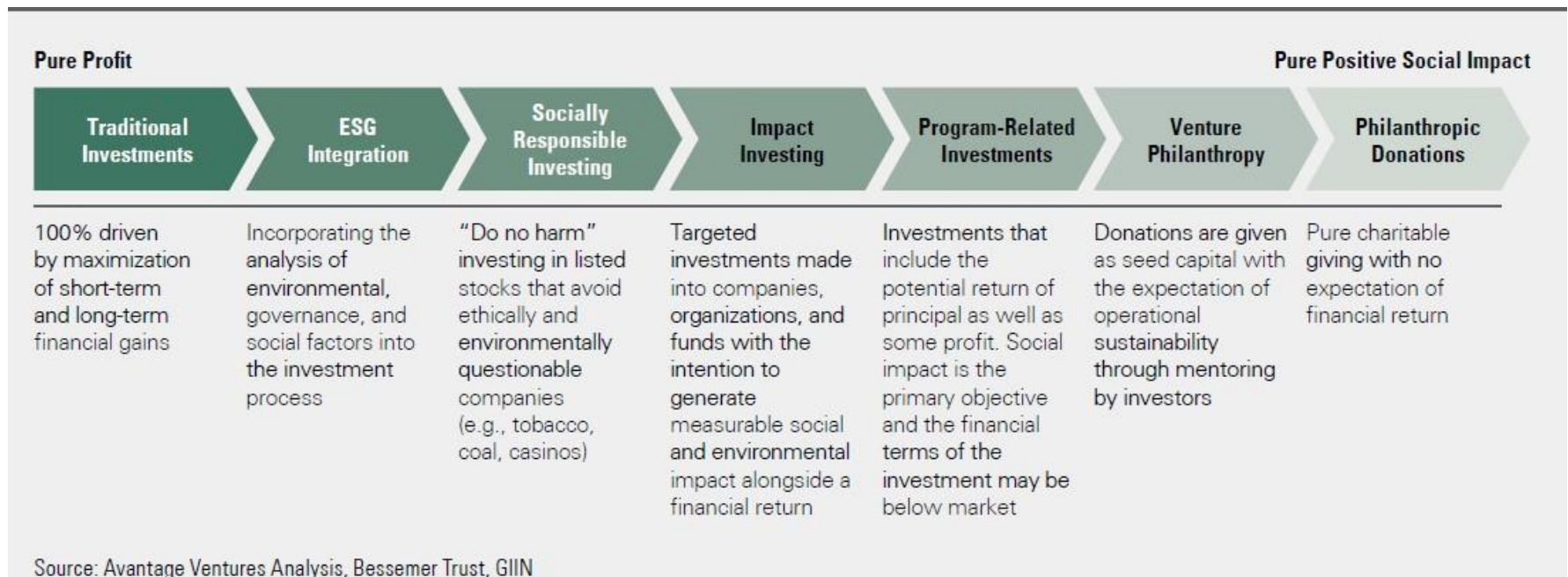
# **Spectrum of social and financial objectives**

# Spectrum of Social and Financial Objectives

Far left of the continuum : traditional investments, whose aim is simply financial return.

Far right : philanthropy, pure charitable giving with no financial return expectations

Middle : various forms of sustainable investing (not exhaustive).



## **Responsible Investing or Socially Responsible Investing (SRI):**

Designed to screen public equity investments of companies or sectors believed to cause social harm --> excludes companies that do not meet your values (weapons, oil, gambling, tobacco, adult entertainment, ...)

## **Sustainable Investing or ESG Investing**

Designed to select public or private equity investments using fundamental analysis that incorporates environmental, social and governance factors

## **Thematic Investing**

Private equity and venture capital investments designed to earn a market risk-adjusted return while also addressing a specific social or environmental problem

## **“Impact First” Investing**

Private investments designed primarily to address a social or environmental problem, with no expectation of achieving market returns

# Impact Investing



# Overhyped?

The field has never been more popular: innovation or rebranding?

**Social impact funds make an impression**

Axa leads with €150m fund to improve access to financial services, healthcare and education

**CRS launches water project at Vatican meeting on impact investing**

**Impact investors shoot for clearer goals**

The popularity of the strategy has prompted some to define its aims more clearly

**Zurich Plans \$5 Billion Allocation to Impact Investments**

PRIVATE EQUITY

**TPG to close impact investing Rise Fund at \$2 billion**

**Impact investing – make good intentions pay**

Spending money to do good is great but defining the desired outcomes is important

**'Millennial generation' most interested in investing to make a positive global impact**

**Sustainable investing assets reach \$12 trillion as reported by the US SIF Foundation's biennial Report on US Sustainable, Responsible and Impact Investing Trends**

**Partners Group launches \$1bn social impact fund to meet demand**

Aim to invest in line with UN's sustainable develop

**The Debate About Impact Investing We Should Be Having**

Axa and WWF call on G7 to act on biodiversity

**Indian microfinance gives birth to smaller banking model**

**Impact Investing, Just A Trend Or The Best Strategy To Help Save Our World?**

INVESTMENT

**Making impact investing more 'mainstream'**

**Third of UBS Assets Are in Sustainable or Impact Investments**

Its quite clear this is no longer a niche anymore, said Group CEO Sergio Ermotti.

**Dutch institutions launch Sustainable Development Goals investing agenda**

**Impact investing deals soar**

**Impact investing offers a solution to the Davos debate**

Impact investing shouldn't be confused with philanthropy – it must earn a good return as well

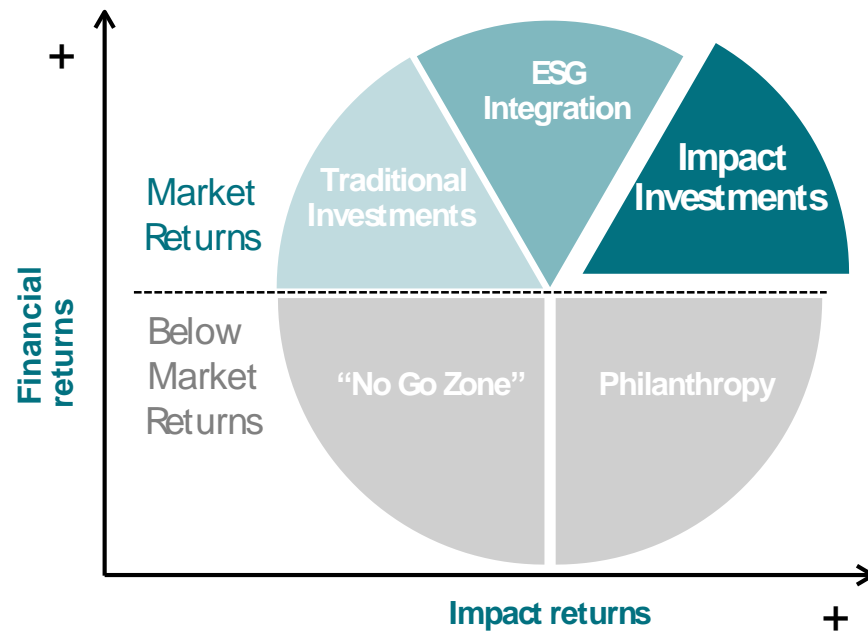
**Insurance giant offers customers chance at impact investing**

For illustrative purposes only. Sources: The Irish News, FT, The Straits Times, Forbes, Huffington Post, Financial News, Citywire, Not for Profit Quarterly, AP News, The Economist, pionline, ncronline.org, Reuters, ABC News, BBC News, Institutional Investor, thisismoney.co.uk, Pensions and Investments, Think Advisor, IPE, Bloomberg, Environmental Finance, pioneerspost.com

# (Very) short history of Impact Investing

- The term « impact investing » was coined in 2007 at a meeting hosted by the Rockefeller Foundation
- Born out of last quarter of the 20th century with Socially Responsible Investment (SRI) and Corporate Responsibility BUT not every socially or environmentally inclined investment is impact investing
- Nascent status: new era of investment in the 21st century?
- Largely practitioner-led (limited academic literature)
- Not a panacea to the world problems and inappropriate for many social enterprises
- Market estimated to be > USD 1 trillion today

# Impact Investing definition



Impact Investing focuses on financing businesses and projects that are designed to have intentional, positive, **measurable and sustainable impacts** on society while *simultaneously* delivering financial market returns

# The five pillars to Impact Investing

Five key pillars to characterize impact investing vs. other approaches to responsible investing



## Intentionality

Investments should be made with an upfront objective of positive social or environmental outcomes. Companies can also demonstrate an intentional, strategic commitment to positive impact



## Scalability

Invest in companies where the positive outcomes are of material significance to the beneficiaries, the company, or to both



## Additionality

The extent to which a company is making its 'needed' products and services more accessible or commercially viable, for example through innovative new solutions or lower pricing.



## Do no harm

Company's corporate practices, or products and services, may significantly undermine the positive impact it is generating elsewhere



## Measurability

There needs to be a clear methodology and commitment to measuring and reporting the social and environmental performance of investments.

# Examples of impact strategies

- Carbon reduction
- Sustainable agriculture
- Renewable energy
- Microfinance
- Obesity reduction
- Health care
- Housing
- Education
- Gun violence
- Place-based Impact Investing
- Gender Lens Investing
- Inclusive Investing (diversity and inclusion)
- Fossil-Fuel-Free Investing

...

# **Impact Investing Wrap up**

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# Impact metrics

- Impact Investing requires a credible, consistent and rigorous set of metrics
- ESG numbers are often self reported by companies
- 150 ESG rating systems including bespoke, non comparable performance metrics with little government oversight
- « Green » label on funds and bonds has no legal basis → if investment in project not green: no legal repercussions, only reputational
- Impact: unclear and varied impact measurement standards across the industry (63% of impact investors use proprietary metrics) → Proliferation of new customized standards → heterogeneity is controversial → efforts made by the Global Impact Investing Network to formalize quantitative metrics
- Intending to create impact vs. actually proving impact
- Underlying risk of « impact washing »: claiming direct social and environmental impacts when these outcomes are not occurring as a direct consequence of the investment

# **Opportunities and challenges**



# Opportunities

- Impact Investing is gradually going mainstream and a shift from Milton Friedman's shareholder value dogma can be seen to include social and environmental impact
- Consumers are willing to pay more for sustainable products
- Employees are willing to work for less when impact is present or will avoid companies that are not socially responsible
- Trust in governments is eroding – in particular in the US – and businesses is seen as more trustworthy
- Academic studies of the link between social responsibility/ESG integration suggest positive causal link with financial performance
- Access to capital has lower constraints for companies with demonstrable impact

# Challenges

There are massive problems in search of efficient and scalable solutions

- expectations are very high!
- investing well to deliver good risk-adjusted returns is hard, adding social and environmental impact is even harder

Not a lot of experience in this “hot sector” :

- shortage of high-quality investment managers with a track record
- risk of impact washing or reputational risk
- Investing is more difficult than fund raising

Impact measurement is challenging, attribution of impact is complex:

- Lack of communication between Impact Investing industry and measurement community
- Perverse incentives for the Impact Investing industry
- Investor desire not to overload their team with difficult to measure non-financial impacts
- Independent evaluators required
- Balance between convergence of approaches/standards and continued innovation
- Impact should not be a lucky by-product

# Final remarks

Forget the evolving terminology: Impact Investing intends to generate financial return and measurable social or environmental benefits → making investment decisions on the basis of risk, return AND measurable impact

Profit and purpose are not mutually exclusive. If impact investors do not seek market return, there is a risk of capital misallocation

Impact Investing can be an engine for change but beware of « impact washing » or do-good enthusiasm not grounded in well-tested professional investing principles (fiduciary duty)

Impact Investing faces serious challenges, including measuring impact accurately

Importance of impact metrics in educating the social entrepreneurs of today and tomorrow